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such conversion under the law applicable to the year in which such conversion was made.

"(2) CONVERSIONS DESCRIBED IN SUBSECTION (a)

(2) In the case of property purchased by the taxpayer in a transaction described in subsection (a)(2) which resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than 1 piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

"(3) PROPERTY HELD BY CORPORATION THE STOCK OF WHICH IS REPLACEMENT PROPERTY.

"(A) IN GENERAL.—If the basis of stock in a corporation is decreased under paragraph (2), an amount equal to such decrease shall also be applied to reduce the basis of property held by the corporation at the time the taxpayer acquired control (as defined in subsection (a)(2)) of such corporation.

"(B) LIMITATION.—Subparagraph (A) shall not apply to the extent that it would (but for this subparagraph) require a reduction in the aggregate adjusted bases of the property of the corporation below the taxpayer's adjusted basis of the stock in the corporation (determined immediately after such basis is decreased under paragraph (2)).

"(C) ALLOCATION OF BASIS REDUCTION.—The decrease required under subparagraph (A) shall be allocated—

"(i) first to property which is similar or related in service or use to the converted property.

"(ii) second to depreciable property (as defined in section 1017(b)(3)(B)) not described in clause (i), and

"(iii) then to other property.

"(D) SPECIAL RULES.

"(i) REDUCTION NOT TO EXCEED ADJUSTED BASIS OF PROPERTY.—No reduction in the basis of any property under this paragraph shall exceed the adjusted

basis of such property (determined without regard to such reduction).

"(ii) ALLOCATION OF REDUCTION AMONG PROPERTY.—If more than 1 property is described in a clause of subparagraph (C), the reduction under this paragraph shall be allocated among such property in proportion to the adjusted bases of such property (as so determined)."

(b) EFFECTIVE DATE.—The amendment made by this section 26^{use 1033}_{note} shall apply to involuntary conversions occurring after the date of the enactment of this Act.

SEC. 1611. TREATMENT OF CERTAIN INSURANCE CONTRACTS ON RETIRED LIVES.

(a) GENERAL RULE.—
(1) Paragraph (2) of section 817(d) (defining variable contract) is amended by striking "or" at the end of subparagraph (A), by striking "and" at the end of subparagraph (B) and